



PIZZA HUT  
CLEVELAND  
INT. BLDG.  
COLUMBUS, OH



Pizza Hut, Inc. Annual Report



Our Business

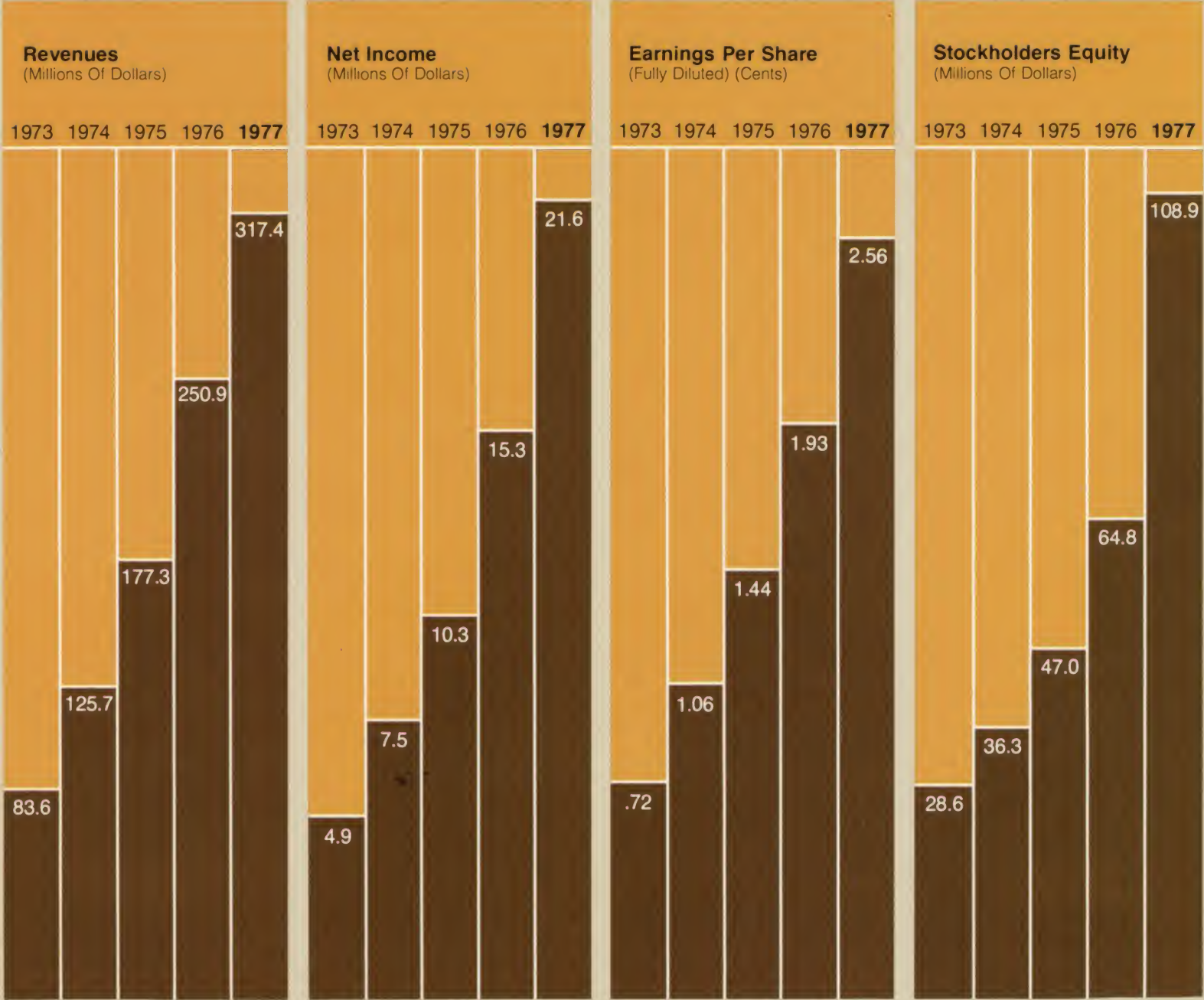
The pictures on the front cover of both the original Pizza Hut unit and the current prototype unit illustrate the dynamic character and growth of Pizza Hut, Inc. Since its inception, the Company has grown into an organization that now numbers 2,820 company owned and franchised family style restaurants, under the name "Pizza Hut." Pizza Hut, Inc. operates 53 per cent and distributes product and equipment to 92 per cent of the total system.

Stock Market Information

PIZ common stock is traded on The New York Stock Exchange. The stock price range on the New York Exchange for the past two years, by quarters, was:

Quarter Ended	1977		1976*	
	High	Low	High	Low
June 30	31-3/8	24-3/8	21	14-1/2
September 30	30-3/8	23-3/4	22-3/8	15-1/4
December 31	28-	22-1/2	24-1/4	18
March 31	27-7/8	19-1/2	29-3/8	20-3/4

\*Adjusted for the 3-for-2 stock split in August, 1975.  
The Company increased its quarterly dividend to \$0.10 per share in February, 1977, which became payable March 31, 1977, indicating an annual dividend of \$0.40 per share.



## Quarterly Review

	1977			1976		
	Sales	Net Income	Earnings Per Share	Sales	Net Income	Earnings Per Share
<b>First Quarter</b> Ended June 30	\$ 71,940,982	\$ 5,133,015	.62	\$ 54,192,105	\$ 3,434,197	.47
<b>Second Quarter</b> Ended September 30	\$ 79,782,808	\$ 5,632,279	.66	\$ 61,914,940	\$ 3,906,092	.49
<b>Third Quarter</b> Ended December 31	\$ 79,530,717	\$ 5,748,789	.67	\$ 64,675,027	\$ 4,246,001	.53
<b>Fourth Quarter</b> Ended March 31	\$ 77,838,656	\$ 5,093,831*	.60*	\$ 64,025,027	\$ 3,675,082	.45
<b>Total</b>	<b>\$309,093,163</b>	<b>\$21,607,914</b>	<b>2.56</b>	<b>\$244,807,099</b>	<b>\$15,261,372</b>	<b>1.93</b>

Earnings per share computations are fully diluted - assuming exercise of options, warrants, and conversion of convertible notes and debentures.

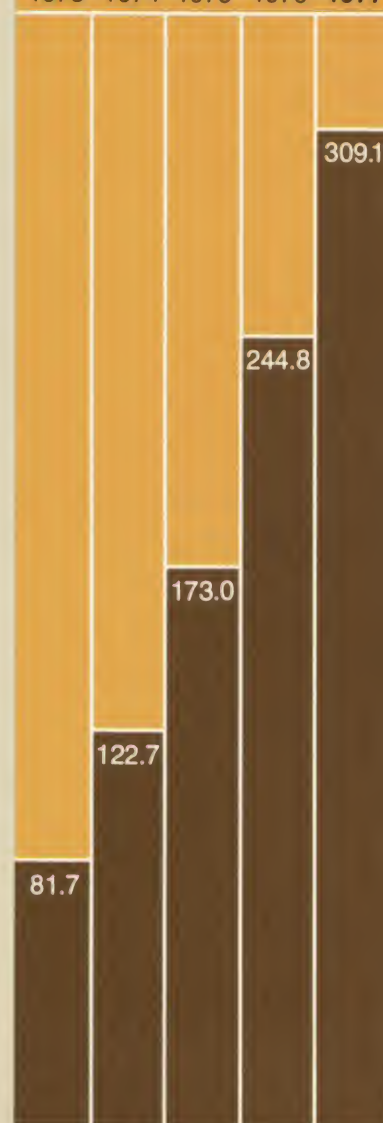
\* Includes an adjustment for income taxes which increased net income by \$640,000 (\$.08 per share). See Note I to Consolidated Financial Statements.

## History of Growth, Five Year Review

(Dollars in thousands)	Fiscal years ended March 31.				
	1977	1976	1975	1974	1973
Net sales	\$309,093	\$244,807	\$173,029	\$122,714	\$81,701
Franchise fees					
Initial	\$ 1,157	\$ 945	\$ 724	\$ 823	\$ 579
Continuing	\$ 7,133	\$ 5,104	\$ 3,592	\$ 2,204	\$ 1,300
Total revenues	\$317,383	\$250,856	\$177,345	\$125,741	\$83,580
Net income	\$ 21,608	\$ 15,261	\$ 10,328	\$ 7,478	\$ 4,912
Percentage to net sales	7.0	6.2	6.0	6.1	6.0
Earnings per share	\$ 2.56	\$ 1.93	\$ 1.44	\$ 1.06	\$ .72
Working capital	\$ 14,460	\$ 29,587	\$ 11,002	\$ 8,478	\$ 6,231
Current ratio	1.43	2.24	1.72	1.65	1.63
Stockholders' equity	\$108,935	\$ 64,785	\$ 47,038	\$ 36,310	\$28,596
Percentage return on average stockholders' equity	24.9	27.3	24.8	23.0	22.9
Total assets	\$165,025	\$138,611	\$ 87,355	\$ 67,205	\$48,121
Number of restaurants (not restated)					
Company owned	1,481	1,246	997	623	490
Franchise system	1,339	1,075	878	864	640
Total	2,820	2,321	1,875	1,487	1,130

## Total Net Sales (Millions Of Dollars)

1973 1974 1975 1976 1977





1958





## Revenues and Contribution to Income

	Fiscal years ended March 31,									
(Dollars in Thousands)	1977		1976		1975		1974		1973	
<b>Revenues:</b>										
Company Pizza Hut restaurants	\$240,865	75.9%	\$197,063	78.6%	\$143,571	81.0%	\$103,240	82.1%	\$70,617	84.5%
Sales to franchisees	66,170	20.9	45,604	18.2	27,374	15.4	16,367	13.0	6,873	8.2
Other restaurants	2,058	.6	2,140	.8	2,084	1.2	3,041	2.4	3,930	4.7
Frozen pizza crusts							66	.1	281	.3
Franchise fees:										
Initial	1,157	.4	945	.4	724	.4	823	.7	579	.7
Continuing	7,133	2.2	5,104	2.0	3,592	2.0	2,204	1.7	1,300	1.6
	<b>\$317,383</b>	<b>100.0%</b>	<b>\$250,856</b>	<b>100.0%</b>	<b>\$177,345</b>	<b>100.0%</b>	<b>\$125,741</b>	<b>100.0%</b>	<b>\$83,580</b>	<b>100.0%</b>
<b>Contribution to Income:</b>										
Company Pizza Hut restaurants (1)	\$43,956	82.8%	\$35,451	85.8%	\$26,233	86.6%	\$19,291	90.3%	\$12,629	91.0%
Sales to franchisees	1,668	3.1	1,052	2.5	652	2.1	358	1.7	263	1.9
Other restaurants	54	.1	165	.4	25	.1	246	1.2	5	
Frozen pizza crusts							(17)	(.1)	(260)	(1.9)
Excess properties (2)	(911)	(1.7)	(1,388)	(3.4)	(948)	(3.1)	(1,551)	(7.3)	(635)	(4.6)
Franchise fees:										
Initial	1,157	2.2	945	2.3	724	2.4	823	3.9	579	4.2
Continuing	7,133	13.5	5,104	12.4	3,592	11.9	2,204	10.3	1,300	9.4
	<b>\$53,057</b>	<b>100.0%</b>	<b>\$41,329</b>	<b>100.0%</b>	<b>\$30,278</b>	<b>100.0%</b>	<b>\$21,354</b>	<b>100.0%</b>	<b>\$13,881</b>	<b>100.0%</b>
General and administrative expenses attributable to the home office and interest income and expense (3)	13,458		13,466		9,926		6,423		4,350	
Income before income taxes	<b>\$39,599</b>		<b>\$27,863</b>		<b>\$20,352</b>		<b>\$14,931</b>		<b>\$ 9,531</b>	

Pizza Hut, Inc. is principally engaged in the operation, development, franchising and servicing of a system of family restaurants under the name "Pizza Hut." Pizza Hut restaurants sell pizza, pasta products, sandwiches and a limited menu of complementary food products at moderate prices prepared under recipes and procedures prescribed by the Company. The Company also manufactures certain fixtures and supplies, processes a variety of spice blends used in its pizza and pasta products, and distributes equipment, supplies and food products for use in its restaurants and sale to franchisees.

The above table sets forth for each of the Company's activities the respective amounts and percentages of revenues and of contribution to consolidated income before general and administrative expenses attributable to the home office, interest income and expenses other than on sales to franchisees and income taxes. The Company believes that allocating such expenses, interest, and taxes would be arbitrary due to the close relationship and interdependency of all its activities.

Expenses (other than general and administrative expenses attributable to the home office) related to "franchise fees" have been allocated to Company Pizza Hut restaurants.

1. Before deducting continuing losses of carrying closed Pizza Hut restaurants amounting to approximately \$130,000, \$313,000, \$227,000, \$193,000, and \$184,000 in the fiscal years 1973 through 1977, respectively, and write-offs of tangible and intangible assets pertaining to such restaurants amounting to approximately \$187,000, \$58,000, \$367,000, and \$103,000 in the fiscal years 1974 through 1977, respectively. Such losses and write-offs are included in "excess properties."

2. Excess properties consist of properties initially owned or leased for restaurant or related purposes but which are now held for disposition, and include closed Fiesta Cantina, Next Door, and Pizza Hut restaurants. The losses from "excess properties" include approximately \$122,000, \$938,000, \$400,000, \$800,000, and \$400,000 in the fiscal years 1973 through 1977, respectively, representing write-offs of tangible and intangible assets pertaining to closed Fiesta Cantina, Next Door, and Pizza Hut restaurants. The balance of such losses consists of expenses incurred in carrying such properties less any income derived from the leasing or disposition of such properties. The Company no longer operates the Fiesta Cantina and Next Door restaurants.

3. The net amount of interest included in general and administrative expenses amounted to approximately \$339,000, \$567,000, \$1,532,000, \$1,890,000 and \$735,000 in the fiscal years 1973 through 1977, respectively.



Fiscal 1977 was a hallmark year for Pizza Hut, Inc. with results that showed increased sales, net income, and earnings per share. Total net sales increased 26 per cent to \$309,093,000, versus the \$244,807,000 of Fiscal 1976. Net income increased 42 per cent to \$21,608,000, as compared to \$15,261,000 for Fiscal 1976, and fully diluted earnings per share were \$2.56 versus \$1.93 one year ago, an increase of 33 per cent. Because of the Company's strong financial position, we increased our dividend during the fourth quarter from the original \$0.03 per share per quarter to \$0.10 per quarter.

The Company met its new unit development goal during the year by opening 204 new Pizza Hut restaurants. Total units in the Pizza Hut system as of March 31, 1977, numbered 2,820, an increase of 21 per cent. Of this total, the Company owned 1,481 units, or 53 per cent, an increase of 19 per cent over last year's 1,246 units. Franchisees owned the remaining 1,339, or 47 per cent, an increase of 25 per cent over last year's 1,075 units. These figures include 45 Company owned and 74 franchise units in 12 foreign countries. Also, during the fiscal year, the Company acquired from franchisees 31 units located in California, Illinois, and Nevada.

In order to better explain the Company's performance in Fiscal 1977, I will discuss some of the influences that affected us during the year. The outside factors were the economy and the weather, which resulted in the intensification of the national fuel crisis. Actions initiated in-house that



had a positive influence during the year included increased marketing efforts, implementation of the decentralized management program and expansion plans for Franchise Services, Inc., our wholly owned distribution subsidiary.

The economic outlook at the beginning of Fiscal 1977 was optimistic, and the economic indicators and forecasters were predicting a good overall scenario. However, the uncertainty of the elections and the fear of inflation were underlying factors which curtailed consumer confidence and created spending patterns in the food service industry which remained erratic most of the year. Despite these uncertainties, Pizza Hut, Inc. showed real sales growth of 2.1 percent on a comparative unit basis for the year. On a quarterly basis, real growth of comparative units was: 1.8 per cent; 1.5 per cent; 1.9 per cent; and 3.4 per cent. The average volume for all units totaled \$185,000 in Fiscal 1977 versus \$179,000 in Fiscal 1976. Growth in sales was attributable to improved consumer demand. The Company did not initiate any price increases during the year.

The weather affected the entire food service industry, including Pizza Hut, Inc., in the third and fourth quarters of Fiscal 1977. This period witnessed the coldest weather recorded in 177 years in some parts of the country and temporarily hampered our opening schedule and business hours in several states. In addition, a fuel shortage in several areas required the Company's further participation in energy conservation programs. In the face of energy shortages,

we voluntarily restricted operating hours in several areas; these practices later became mandatory in many parts of the country. However, we were able to minimize the adverse effects of the restrictions by operating during our peak business periods with affected units operating from 12:00 noon to 3:00 p.m. and 5:00 p.m. to 10:00 p.m. weekly, with 12:00 midnight closings on weekends. In addition, some units closed on their slowest days to conserve energy and overhead costs.

We have recognized for some time the likelihood of fuel shortages and have been placing our orders for gas versus electric ovens based on energy resources in each geographical area. Our current order rate is running about 50 per cent gas and 50 per cent electric. The current mix of ovens presently in use is 60 per cent gas, 40 per cent electric.

During the past year, we increased our marketing emphasis as well as our research efforts. The formulation and introduction of new products and product extensions are the ongoing responsibilities of our Marketing and Research and Development Departments. These departments have a number of products in test markets at all times, with the tests designed to indicate to Pizza Hut, Inc. both the acceptability and preference of each product by the consumer. Before a product is introduced into the marketplace, it must meet our minimum criteria of approximately 70 per cent repeat purchase intention by the customer. Test results on new products and ongoing customer



preferences are obtained not only through various in-house research reports, but also the CREST Study which indicates the behavior and purchase activities of the consumer.

During Fiscal 1977, Pizza Hut, Inc. introduced two new supreme sandwiches: meatball and Italian sausage. In addition, the smorgasbord and a more extensive salad bar were introduced in most of our units. These products and marketing formats offer an opportunity to further develop our luncheon business. However the salad bar and sandwiches also offer our customers a broader product choice during other periods as well. These items were partially introduced during the year with complete implementation scheduled during the first quarter of Fiscal 1978. These items will be used in locations where customer traffic patterns indicate a potential marketing benefit. We expect the smorgasbord to be in 80 per cent of the Company's units, the sandwich items in nearly 100 per cent of the units, and salad bars in approximately 90 per cent of the units.

An initial product acceptance problem developed in Coastal New England and Long Island which involved 46 stores. This area has a large number of independent Italian restaurants which give the consumer comparative attitudes on ethnic food products. Our products initially lacked local acceptance because they did not meet the long established local product style. The products were retested by our Research and Development Department to meet the regional taste preferences, reformulated according to consumer dictates, and have



since been accepted with good results. In addition to solving a singular regional acceptance problem, the reformulation of the products further proved that we can and will meet customer needs regardless of local or regional preferences.

With the increasing emphasis on marketing in Fiscal 1977, our Advertising Committee, comprised of both Company and franchise representatives, changed our advertising agency. Our past growth rates and future growth objectives warranted the selection of a larger agency offering a broader base of services. Foote, Cone & Belding, the agency selected, is now working to further strengthen our marketing efforts through new, systemwide marketing and advertising programs. During the past fiscal year, Pizza Hut, Inc. spent \$9.8 million on national and local advertising, while franchisees spent about \$8.0 million in both areas. These advertising dollars were spent on a variety of programs. We ran special advertising pushes which highlighted specific product groups, such as our "Supreme" products commercials. We also took the lead advertising position on a national television show for the first time with the Dick Clark Special, which proved to be quite successful. During the past year, we initiated a new advertising theme. Our past theme of "There are a lot of good things under our roof" has been replaced with "Let yourself go." We believe that the phrase "Let yourself go to Pizza Hut" communicates the feeling of excitement and the creation of an experience which is unique at a Pizza Hut restaurant.



**Let  
Yourself  
Go!**



A significant organizational change that took place late in the year was the completion of our decentralization program. During Fiscal 1976, we began working toward decentralized field management. At that time, we established the Central Division as a test area to be headed by a Vice President. Our objective was to evaluate the best method of making field decisions pertaining to the real estate, construction, restaurant operations, local advertising and promotional functions. Decentralization guidelines were developed as a result of the test and implementation was started during the year. Our domestic restaurant operations divisions are now led by four Divisional Vice Presidents working with 13 Regional Managers, 36 District Managers, 192 Area General Managers, and 1,436 Unit Managers.





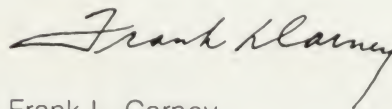
Franchise Services, Inc. (FSI), our wholly owned subsidiary, purchases, warehouses, and distributes a virtually complete line of food products, equipment, fixtures, and general supplies needed to operate each Pizza Hut restaurant. FSI presently serves 92 per cent of the system's units and ended Fiscal 1977 with eight product distribution centers. During the year, we closed one center in Peoria, Illinois, and opened two centers, one each in Colorado and Kansas. These new centers are 25,000 square feet and 45,000 square feet, respectively. Plans for Fiscal 1978 call for opening two new distribution centers: one in Minneapolis, Minnesota, in July, 1977, and one in Jackson, Mississippi, in early 1978. In addition to the eight product distribution centers, we maintain a centrally located equipment distribution center in Wichita, Kansas, to provide coordinated equipment deliveries and assist in timely unit openings.

Commodity purchasing is another responsibility of FSI that is very significant for the Pizza Hut system. Each commodity requires different purchase cycles. Tomatoes are contracted yearly, meat (primarily pork) monthly, and cheese, our largest purchase, weekly. Flour and vegetable oil are purchased quarterly. Produce, bread, and beverages are normally purchased at the local level under the Area General Manager's supervision. Some commodity cost benefits were experienced this past year, with most of our major commodity costs being lower than in Fiscal 1976.

Pizza Hut, Inc., through FSI, continues to broaden the product line available to the system. Most commodities are backed by a minimum of three to four suppliers, thus assuring good quality and a continuous supply should any contingencies arise. The exception to this policy is FSI's spice blending operation. This blend is the only product franchisees must purchase from the Company. FSI sells products to franchisees under an agreement that limits the pre-tax earnings on unit sales to 2.5 per cent.

The systemwide dedication of Company personnel and franchisees has enabled the Pizza Hut system to achieve a prominent position in the food service industry. We look forward to the programs and challenges awaiting us in Fiscal 1978. Present plans call for the development of a minimum of 225 Company operated units during the year and we anticipate that franchisees will open at least an equivalent number. We are pleased with the results obtained in Fiscal 1977 and look forward to reporting excellent results to you throughout Fiscal 1978.

Respectfully,



Frank L. Carney  
President and Chairman of the Board



## Officers

**Gerald T. Aaron**  
Secretary

**Charles L. Boppell**  
Vice President  
Western Division

**Frank L. Carney**  
President &  
Chairman of the Board

**Richard N. Chaput**  
Vice President  
Franchising

**Robert E. Cressler**  
Vice President  
Applegate's Landing

**Michael W. Dart**  
Vice President  
Financial Services

**Farris S. Farha**  
Sr. Vice President  
Administration

**Joseph P. Flynn**  
Vice President  
International

**Neil D. Frumkin**  
Vice President  
Property Management

**Rodney R. Hatter**  
Asst. Secretary

**Frank J. Holdraker**  
Vice President  
Southern Division

**Frederick A. Huggins, Jr.**  
Vice President  
Eastern Division

**Robert L. Logsden**  
Sr. Vice President  
Marketing

**Kenneth R. Miller**  
Group Vice President

**Samuel E. Moyers**  
Vice President  
Advertising & Market Planning

**R. Michael Niemann**  
Vice President  
Central Division

**Thomas W. Orr**  
Vice President  
Distribution & Food Processing

**John H. Slaymaker**  
Group Vice President  
& Chief Financial Officer

**Max Sutton**  
Treasurer

**Daniel J. Taylor**  
Vice President  
Corporate Development

**M. Hal Taylor**  
Group Vice President

## Directors

**Frank L. Carney**  
President &  
Chairman of the Board

**Daniel M. Carney**  
Investments

**G. E. Engleman**  
Chairman of the Board  
Union Bank of Ft. Worth &  
First National Bank, Hurst, Texas

**Martin T. Hart**  
Investments

**Lester Pollack**  
Executive Vice President  
Loews Corporation

**Louis Pozez**  
President  
Volume Shoe Corporation

**King D. Shwayder**  
President  
Samsonite Corporation

**Daniel J. Taylor**  
Vice President  
Corporate Development

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### Annual Meeting

The Annual Meeting of Shareholders will be held at 9:00 A.M., Monday, August 8, 1977 at the Corporate offices, Wichita, Kansas. A formal notice of the meeting, together with proxy material, is being sent separately to shareholders.



## Board of Directors



Martin T. Hart    Louis Pozez



Lester Pollack    Daniel M. Carney    Daniel J. Taylor



Frank L. Carney



G. E. Engleman    King D. Shwayder



## Five Year Summary of Operations

Fiscal years ended March 31,

	1977	1976	1975	1974	1973
Net sales					
Restaurant sales . . . . .	<b>\$242,922,806</b>	\$199,203,057	\$145,655,227	\$106,347,021	\$74,827,901
Product sales to					
franchisees . . . . .	<b>66,170,357</b>	45,604,042	27,374,213	16,366,663	6,872,695
Total net sales . . . . .	<b>309,093,163</b>	244,807,099	173,029,440	122,713,684	81,700,596
Cost of sales					
Restaurant . . . . .	<b>65,862,993</b>	55,465,194	39,150,169	29,551,887	19,434,282
Product sales to					
franchisees . . . . .	<b>61,583,671</b>	42,286,068	24,970,676	15,024,201	5,879,679
Total cost of sales . . . .	<b>127,446,664</b>	97,751,262	64,120,845	44,576,088	25,313,961
Gross profit . . . . .	<b>181,646,499</b>	147,055,837	108,908,595	78,137,596	56,386,635
Initial franchise fees . . . . .	<b>1,157,000</b>	945,000	724,000	823,500	579,000
Continuing franchise fees . . .	<b>7,132,720</b>	5,104,344	3,591,901	2,203,841	1,300,473
Equity in net income or					
losses of unconsolidated					
foreign subsidiaries and					
minority-owned affiliates . .	<b>438,004</b>	109,216	(702,943)	(313,004)	(15,951)
	<b>190,374,223</b>	153,214,397	112,521,553	80,851,933	58,250,157
Selling, general and					
administrative expenses . . .	<b>150,829,312</b>	123,623,333	90,981,843	65,701,462	48,484,960
	<b>39,544,911</b>	29,591,064	21,539,710	15,150,471	9,765,197
Other income . . . . .	<b>2,568,945</b>	1,836,329	930,486	1,155,168	624,093
	<b>42,113,856</b>	31,427,393	22,470,196	16,305,639	10,389,290
Interest expense . . . . .	<b>2,514,942</b>	3,564,021	2,117,849	1,374,413	858,278
Income before income taxes .	<b>39,598,914</b>	27,863,372	20,352,347	14,931,226	9,531,012
Provision for income taxes . .	<b>17,991,000</b>	12,602,000	10,024,147	7,452,755	4,618,722
Net income . . . . .	<b>\$ 21,607,914</b>	\$ 15,261,372	\$ 10,328,200	\$ 7,478,471	\$ 4,912,290
Net income per share:					
Primary . . . . .	\$2.67	\$2.10	\$1.47	\$1.06	\$ .72
Fully diluted . . . . .	\$2.56	\$1.93	\$1.44	\$1.06	\$ .72



## Management's Discussion and Analysis of the Summary of Operations

### Sales

#### Total net sales:

The Company has experienced a compounded annual sales growth of approximately 39 per cent over the last five years. The percentage increase was 26 per cent in 1977 compared to 41 per cent in 1976.

The growth was a result of increased annual unit sales volume, new unit development and increased product sales to franchisees.

#### Restaurant sales:

The growth in restaurant sales was 21 per cent in 1977 and 37 per cent in 1976. The decrease in percentage growth for 1977 is attributable to the difference in the average unit sales growth and the stable pace of new unit development. New unit development in 1977 and 1976 was 204 and 207, respectively. Average unit volume on a comparative unit basis increased 5.1 per cent in 1977 and 12.5 per cent in 1976. Taking into account the effect of price increases in 1976 and 1975, "real" sales growth on a comparative unit basis was 2.1 per cent in 1977 and 6.6 per cent in 1976. "Real" sales growth is computed for units open 13 months or more. The average unit sales volume chart below is computed for all units.

#### Product sales to franchisees:

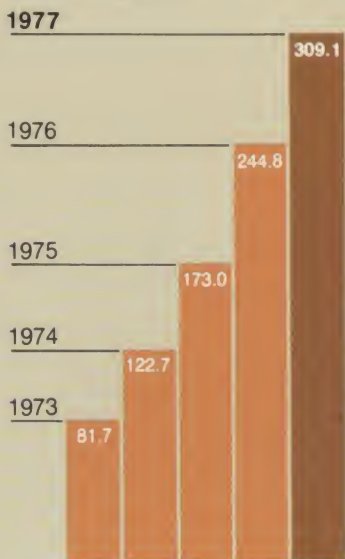
This category includes the sales of equipment, food products, and supplies to franchised units. Product sales to franchisees increased 45 per cent in 1977 and 67 per cent in 1976. The increases are due primarily to increases in average unit volumes, new franchised unit development, and additional distribution centers. Two additional centers were opened in 1976 and one in 1977. The additional centers were able to increase system units served on a weekly basis from 74 per cent in 1975 to 92 per cent in 1976 and 1977. Product sales to franchisees were 21 per cent of total net sales in 1977 as compared to 19 per cent in 1976.

<b>1977</b>	<b>\$309,093,163</b>
1976	\$244,807,099
1975	\$173,029,440

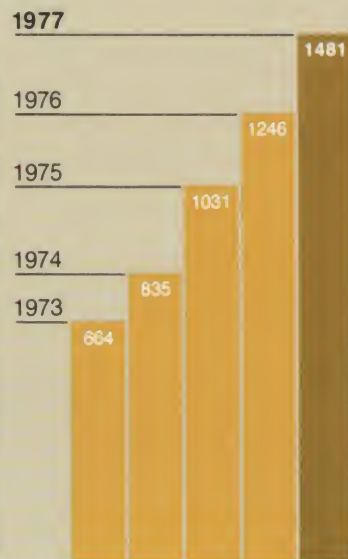
<b>1977</b>	<b>\$242,922,806</b>
1976	\$199,203,057
1975	\$145,655,227

<b>1977</b>	<b>\$66,170,357</b>
1976	\$45,604,042
1975	\$27,374,213

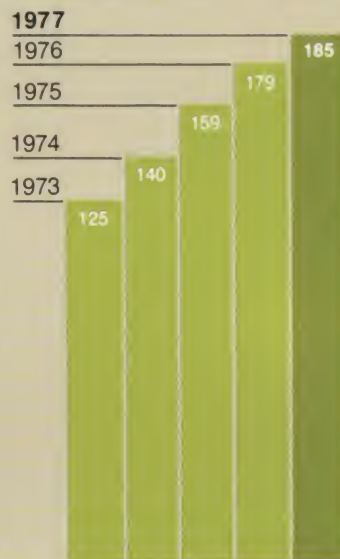
Total Net Sales  
(Millions of Dollars)



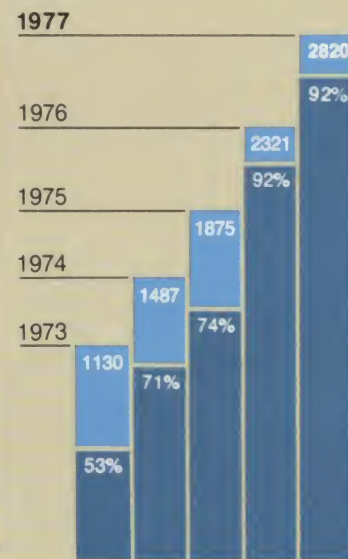
Company Operated Units



Average Annual Unit Volumes  
(Thousands of Dollars)



Total Systemwide Units  
Served by FSI





## Cost of Sales

### Total cost of sales:

Total cost of sales was 41 per cent in 1977 compared to 40 per cent in 1976. The increase is due primarily to the increase in product sales to franchisees. The following charts illustrate the mix of the two sales categories with their related cost of sales percentages.

<b>1977</b>	<b>\$127,446,664</b>
1976	\$ 97,751,262
1975	\$ 64,120,845

### Cost of sales - restaurants:

Restaurant cost of sales was 27 per cent in 1977 and 28 per cent in 1976. The decrease is due primarily to increased raw material costs in 1976 not passed through by price increases until mid-year. Additional factors in 1977 were efficiencies achieved in distribution of food and supplies which lowered transportation costs to restaurants, the additional distribution centers which serviced some restaurants at a lower price as compared to former suppliers, and the somewhat lower costs of commodities which have been passed through to the restaurants.

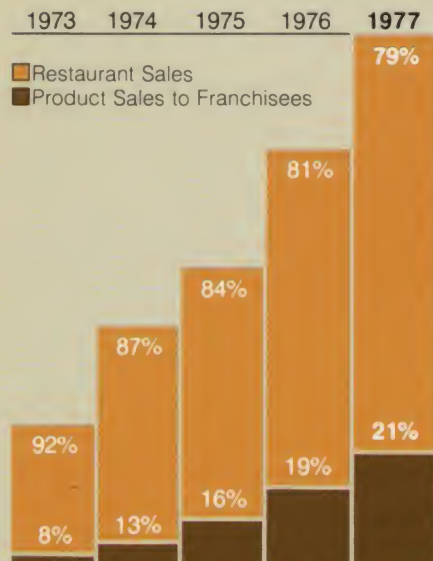
<b>1977</b>	<b>\$65,862,993</b>
1976	\$55,465,194
1975	\$39,150,169

### Cost of sales - product sales to franchisees:

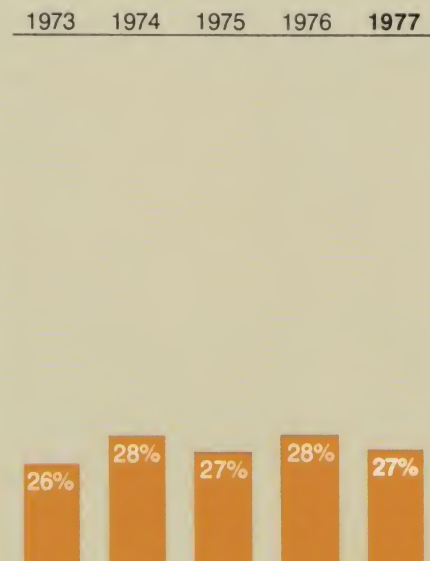
Product sales to franchisees averaged 93 per cent in 1977 and 1976. The dollar increase in this category relates to sales growth. Lower costs of certain commodities were offset by price reductions to restaurant units.

<b>1977</b>	<b>\$61,583,671</b>
1976	\$42,286,068
1975	\$24,970,676

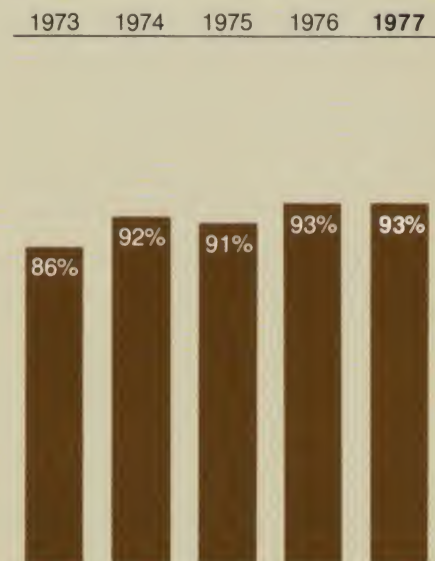
### Distribution of Total Net Sales



### Restaurant Cost of Sales (Expressed as a percentage of restaurant sales)



### Product Cost of Sales (Expressed as a percentage of product sales to franchisees)



## Other Income

### Initial franchise fees:

The Company receives an initial fee upon the opening of each new franchised Pizza Hut restaurant. The amounts of the fees have varied over the years, but generally range between \$4,000 and \$6,000 for each unit opened. The change in initial fee income is directly related to the number of franchised units opened each year.

<b>1977</b>	<b>\$1,157,000</b>
1976	\$ 945,000
1975	\$ 724,000

### Other income:

This category primarily includes the interest income on funds held pending use in the development of new Pizza Hut restaurants for the Company. The fluctuation in such income is attributable to the timing of the use of the funds and the fluctuation in short term interest rates. The 1977 amount includes a gain on the sale of a minority interest in a joint venture and the gains on sale of Fiesta Cantina operations during the year.

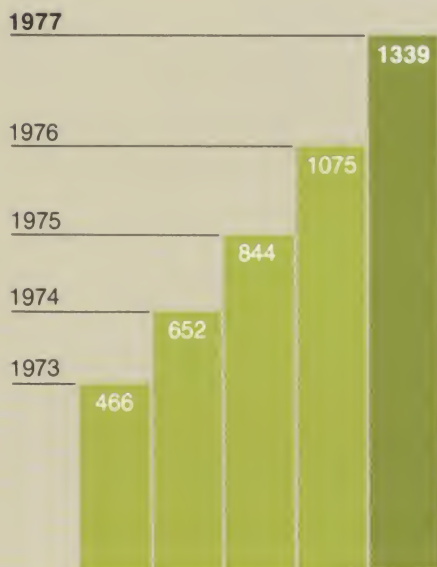
<b>1977</b>	<b>\$2,568,945</b>
1976	\$1,836,329
1975	\$ 930,486

### Continuing franchise fees:

Each franchised Pizza Hut restaurant pays a monthly fee to the Company which is usually computed as a percentage of sales. The increases in 1977 and 1976 are directly related to the new franchised units opened during each year and the increases in average annual unit sales volume.

<b>1977</b>	<b>\$7,132,720</b>
1976	\$5,104,344
1975	\$3,591,901

### Total Number of Franchised Units

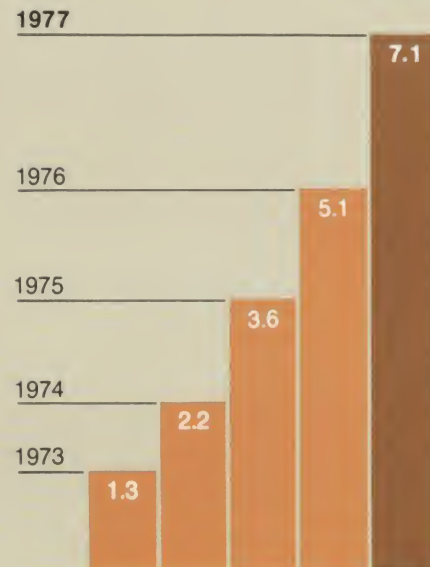


### Equity in foreign subsidiaries and minority-owned affiliates:

The results in 1977 were due to an overall improvement in international operations with the United Kingdom, Mexican operations, and certain domestic joint ventures making the greatest improvement in contribution. In 1976 the discontinuation of German operations was the major contributing factor compared to 1975.

<b>1977</b>	<b>\$ 438,004</b>
1976	\$ 109,216
1975	\$(702,943)

### Continuing Fee Income (Millions of Dollars)





## Selling, General, and Administrative Expenses

Expenses in this category have decreased to 49 per cent of sales in 1977 from 50 per cent in 1976. The decreased percentage in 1977 is due primarily to efficiencies achieved at the unit level and in home office administration. For 1976 the category also includes charges of approximately \$670,000 relating to the discontinuation of operations in Germany. The total dollar increases including depreciation and amortization, taxes, and rents, for the most part, have increased at a rate consistent with the growth of the Company.

Amounts spent on advertising have increased over the last three years. The amounts spent on national and local advertising were \$9.8 million, \$8.0 million, and \$5.5 million in 1977, 1976 and 1975, respectively.

## Interest Expense

The issuance of \$25,000,000 of convertible subordinated debentures in 1976 is the direct cause of the increase in that year. The conversion of the debentures into Common Stock in 1977 is the primary reason for the decrease in 1977.

## Income Taxes

The effective income tax rate was 45.4 per cent in 1977, 45.2 per cent in 1976, and 49.3 per cent in 1975. The lower tax rate in 1976 is attributable mainly to increased investment tax credits and the tax benefits associated with the discontinuation of German operations. The effective tax rate in 1977 was comparable to 1976 primarily due to increased investment tax credits. In addition, for all years presented, there were no United States taxes provided on foreign income (loss) since the Company considers all undistributed earnings of foreign subsidiaries permanently reinvested in the businesses.

1977	\$150,829,312	1977	\$2,514,942	1977	\$17,991,000
1976	\$123,623,333	1976	\$3,564,021	1976	\$12,602,000
1975	\$ 90,981,843	1975	\$2,117,849	1975	\$10,024,147

## Pizza Hut Restaurants By State As of March 31, 1977

State	Company	Franchise	State	Company	Franchise	State	Company	Franchise
Alabama	7	46	Maine		4	Oklahoma	37	50
Alaska		4	Maryland	1	16	Oregon	9	2
Arizona	24	19	Massachusetts	4	3	Pennsylvania	41	34
Arkansas		58	Michigan	30	28	Rhode Island	2	
California	89	24	Minnesota	9	28	South Carolina	42	19
Colorado	38	26	Mississippi		34	South Dakota	15	
Connecticut	11		Missouri	46	49	Tennessee	47	34
Florida	62	80	Montana		10	Texas	146	163
Georgia	81	3	Nebraska	30	21	Utah	21	2
Hawaii		10	Nevada	11		Virginia	57	32
Idaho		8	New Hampshire	19		Washington	39	2
Illinois	79	76	New Jersey		2	West Virginia	8	10
Indiana	58	38	New Mexico	28	10	Wisconsin	57	17
Iowa	29	43	New York	59	10	Wyoming		3
Kansas	39	60	North Carolina	23	76	International	45	74
Kentucky	17	32	North Dakota	4	6	<b>Total</b>	<b>1481</b>	<b>1339</b>
Louisiana	50	20	Ohio	67	53	<b>GRAND TOTAL</b>	<b>2820</b>	

## Statements of Consolidated Income

Pizza Hut, Inc. and Subsidiaries

	Years ended March 31,	
	1977	1976
Net sales		
Restaurant sales	\$242,922,806	\$199,203,057
Product sales to franchisees	66,170,357	45,604,042
<b>TOTAL NET SALES</b>	<b>309,093,163</b>	<b>244,807,099</b>
Cost of sales		
Restaurant	65,862,993	55,465,194
Product sales to franchisees	61,583,671	42,286,068
<b>TOTAL COST OF SALES</b>	<b>127,446,664</b>	<b>97,751,262</b>
<b>GROSS PROFIT</b>	<b>181,646,499</b>	<b>147,055,837</b>
Initial franchise fees	1,157,000	945,000
Continuing franchise fees	7,132,720	5,104,344
Equity in net income of unconsolidated foreign subsidiaries and minority-owned affiliates	438,004	109,216
	190,374,223	153,214,397
Selling, general, and administrative expenses	150,829,312	123,623,333
	39,544,911	29,591,064
Other income (including interest: 1977 - \$1,906,937; 1976 - \$1,752,708)	2,568,945	1,836,329
	42,113,856	31,427,393
Interest expense	2,514,942	3,564,021
<b>INCOME BEFORE INCOME TAXES</b>	<b>39,598,914</b>	<b>27,863,372</b>
Provision for income taxes - Note G	17,991,000	12,602,000
<b>NET INCOME</b>	<b>\$ 21,607,914</b>	<b>\$ 15,261,372</b>
Net income per share - Note A:		
Primary - assuming exercise of options and warrants		
1977 - 8,103,763		
1976 - 7,268,982	<u>\$2.67</u>	<u>\$2.10</u>
Fully diluted - assuming, in addition, conversion of 6-1/4% debentures and convertible notes		
1977 - 8,524,934		
1976 - 8,219,302	<u>\$2.56</u>	<u>\$1.93</u>

See notes to consolidated financial statements.



## Consolidated Balance Sheets

Pizza Hut, Inc. and Subsidiaries

	March 31,	
	1977	1976
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash .....	\$ 3,887,124	\$ 4,915,675
Certificates of deposit .....	22,000,000	30,150,000
Receivables:		
Notes .....	167,390	52,595
Trade accounts .....	7,574,853	5,474,178
Other accounts .....	1,662,435	1,630,303
Allowance for doubtful notes and accounts .....	(182,500)	(182,500)
	9,222,178	6,974,576
Inventories .....	12,170,128	10,712,079
Prepaid expenses .....	573,686	687,890
<b>TOTAL CURRENT ASSETS</b> .....	47,853,116	53,440,220
<b>INVESTMENTS AND OTHER ASSETS</b>		
Investments in and advances to unconsolidated affiliates:		
Foreign subsidiaries .....	4,942,109	4,730,568
Other affiliates .....	291,358	467,318
	5,233,467	5,197,886
Cost in excess of net assets of businesses acquired, less amortization .....	4,271,578	3,787,077
Patents, service marks, and franchises .....	1,691,746	1,628,639
Other accounts .....	3,912,995	3,032,906
	15,109,786	13,646,508
<b>PROPERTY, PLANT, AND EQUIPMENT - Note C</b>		
Land .....	20,060,871	13,616,934
Buildings and improvements .....	26,038,413	18,078,265
Leasehold improvements .....	18,781,735	14,740,431
Operating equipment .....	56,322,094	39,841,066
Construction in progress (estimated cost to complete - \$4,300,000) .....	3,739,422	
	124,942,535	86,276,696
Allowance for depreciation and amortization (deduction) .....	(23,206,934)	(16,419,846)
	101,735,601	69,856,850
<b>DEFERRED CHARGES</b> .....	326,322	1,667,683
	<u>\$165,024,825</u>	<u>\$138,611,261</u>

See notes to consolidated financial statements.

	March 31,	
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>1977</b>	<b>1976</b>
<b>CURRENT LIABILITIES</b>		
Trade accounts payable .....	\$14,956,621	\$ 8,552,219
Taxes, other than income .....	3,314,422	2,591,310
Federal and state income taxes .....	8,016,022	7,006,755
Employee compensation .....	3,716,517	889,987
Other accrued expenses .....	2,970,695	3,511,554
Current portion of long-term debt .....	418,997	1,301,285
<b>TOTAL CURRENT LIABILITIES</b>	<b>33,393,274</b>	<b>23,853,110</b>
<b>LONG-TERM DEBT - less portion classified as current liability - Note C:</b>		
6-1/4% convertible debentures .....		23,691,000
Other .....	19,268,140	23,429,557
	<b>19,268,140</b>	<b>47,120,557</b>
<b>DEFERRED INITIAL FRANCHISE FEE INCOME</b> .....	<b>824,600</b>	<b>852,400</b>
<b>ESTIMATED FUTURE LEASE COSTS</b> .....	<b>2,400,000</b>	<b>2,000,000</b>
<b>DEFERRED INCOME TAXES</b> .....	<b>204,015</b>	
<b>STOCKHOLDERS' EQUITY - Notes C and E</b>		
Preferred Stock - \$0.01 par value		
Authorized 1,000,000 shares; none issued		
Common Stock - \$0.01 par value		
Authorized 20,000,000 shares; issued and outstanding 8,361,989 shares in 1977 and 7,172,945 shares in 1976 .....	83,620	71,729
Other capital .....	567,919	567,919
Additional paid-in capital .....	44,870,108	20,791,342
Retained earnings .....	63,414,713	43,355,768
Treasury Stock (7,282 shares) at cost .....	(1,564)	(1,564)
	<b>108,934,796</b>	<b>64,785,194</b>
<b>LEASES AND CONTINGENT LIABILITIES - Notes F and H</b>		
	<b>\$165,024,825</b>	<b>\$138,611,261</b>



## Statement of Consolidated Stockholders' Equity

Pizza Hut, Inc. and Subsidiaries

Years ended March 31, 1977 and 1976

	Common Stock Shares	Common Stock Amount	Other Capital	Additional Paid-in Capital	Retained Earnings	Treasury Stock
Balance at April 1, 1975 .....	4,749,953	\$47,500	\$362,547	\$18,015,694	\$28,613,760	\$(1,564)
Adjustment for three for two stock split .....	2,228,542	22,285		(22,285)		
Pooled company's fractional shares sold .....	8,153	82		(82)		
Fractional shares on three for two stock split paid in cash .....	(3,581)	(36)		(2,563)		
Capitalization of undistributed partnership earnings .....			205,372		(205,372)	
Pooled company's dividends and distributions prior to acquisition .....					(100,000)	
Amounts received to exercise and extend employee stock options .....	76,929	769		843,841		
Conversion of 7% and 8% convertible notes .....	52,546	525		674,475		
Conversion of 6-1/4% convertible debentures .....	60,403	604		1,282,262		
Dividends on Common Stock (\$0.03 per share) .....					(213,992)	
Net income .....					15,261,372	
<b>BALANCE AT MARCH 31, 1976 .....</b>	<b>7,172,945</b>	<b>71,729</b>	<b>567,919</b>	<b>20,791,342</b>	<b>43,355,768</b>	<b>(1,564)</b>
Acquisition of purchased company - Note B .....	15,000	150		297,975		
Pooled company's fractional shares sold .....	674	7		(95)		
Amounts received to exercise and extend employee stock options .....	62,656	627		799,986		
Amounts received to exercise other stock options .....	13,337	133		51,016		
Conversion of 8% convertible note .....	4,415	44		24,956		
Conversion of 6-1/4% convertible debentures .....	1,092,962	10,930		22,904,928		
Dividends on Common Stock (\$0.19 per share) .....					(1,548,969)	
Net income .....					21,607,914	
<b>BALANCE AT MARCH 31, 1977 .....</b>	<b>8,361,989</b>	<b>\$83,620</b>	<b>\$567,919</b>	<b>\$44,870,108</b>	<b>\$63,414,713</b>	<b>\$(1,564)</b>

See notes to consolidated financial statements.

## Statements of Changes in Consolidated Financial Position

Pizza Hut, Inc. and Subsidiaries

	Years ended March 31,	
	1977	1976
<b>SOURCE OF FUNDS</b>		
Net income .....	\$ 21,607,914	\$15,261,372
Charges (credits) to income not affecting funds:		
Depreciation and amortization .....	7,925,151	6,027,550
Deferred income taxes .....	1,012,653	383,663
Deferred initial franchise fees .....	(27,800)	86,200
Provision for future lease costs .....	400,000	800,000
Equity in net (income) loss of unconsolidated foreign subsidiaries and minority-owned affiliates .....	(438,004)	(109,216)
<b>TOTAL FROM OPERATIONS</b> .....	<b>30,479,914</b>	<b>22,449,569</b>
Proceeds from long-term debt .....		29,174,576
Conversion of convertible debentures and notes .....	22,940,858	1,957,866
Disposals of property, plant, and equipment including sale and leaseback transactions .....	6,541,535	9,140,926
Amounts received to exercise and extend stock options .....	851,762	844,610
Other items .....	1,150,458	193,198
	<u>61,964,527</u>	<u>63,760,745</u>
<b>APPLICATION OF FUNDS</b>		
Assets of purchased companies:		
Property, plant, and equipment .....	1,357,967	92,982
Franchise rights and other assets .....	221,774	27,735
Cost in excess of net assets acquired .....	554,927	275,751
Long-term debt assumed .....		(45,832)
	<u>2,134,668</u>	<u>350,636</u>
Additions to property, plant, and equipment .....	44,726,413	37,050,141
Reductions of long-term debt .....	27,852,417	5,208,870
Investments in and advances to unconsolidated foreign subsidiaries and minority-owned affiliates .....		1,275,639
Dividends on common stock .....	1,548,969	213,992
Other items .....	829,328	1,075,977
	<u>77,091,795</u>	<u>45,175,255</u>
<b>INCREASE (DECREASE) IN WORKING CAPITAL</b> .....	<u><b>\$(15,127,268)</b></u>	<u><b>\$18,585,490</b></u>
<b>INCREASE (DECREASE) IN WORKING CAPITAL BY COMPONENT</b>		
Cash .....	\$ (1,028,551)	\$ (956,238)
Certificates of deposit .....	(8,150,000)	30,150,000
Properties held for sale and leaseback .....		(7,532,695)
Trade and other receivables .....	2,247,602	3,346,457
Inventories .....	1,458,049	2,056,279
Prepaid expenses .....	(114,204)	132,506
Trade accounts payable .....	(6,404,402)	(2,332,780)
Taxes, other than income .....	(723,112)	(707,487)
Federal and state income taxes .....	(1,009,267)	(3,153,481)
Employee compensation .....	(2,826,530)	(767,781)
Other accrued expenses .....	540,859	(1,852,532)
Current portion of long-term debt .....	882,288	203,242
<b>INCREASE (DECREASE) IN WORKING CAPITAL</b> .....	<u><b>\$(15,127,268)</b></u>	<u><b>\$18,585,490</b></u>

See notes to consolidated financial statements.



## Notes to Consolidated Financial Statements

Pizza Hut, Inc. and Subsidiaries

### NOTE A — ACCOUNTING POLICIES

#### PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of all domestic subsidiaries after elimination of significant intercompany accounts and transactions.

#### FOREIGN SUBSIDIARIES AND OTHER AFFILIATES

Investments in wholly-owned subsidiaries in Australia, Canada, Mexico, Japan, and England and investments in certain minority-owned domestic affiliates are carried at cost plus equity in net income of the foreign subsidiaries and domestic affiliates. The assets, liabilities, revenues, and net income (losses) of these foreign subsidiaries were not significant.

#### INVENTORIES

Inventories are stated at the lower of cost (first-in, first-out method) or market.

#### PROPERTY, PLANT, AND EQUIPMENT AND DEPRECIATION POLICIES

Property, plant, and equipment is carried on the basis of cost and depreciation is determined principally by the straight-line method over the following ranges of useful lives:

Buildings and improvements	20 to 40 years
Operating equipment	3 to 10 years
Leasehold improvements	Term of lease

#### AMORTIZATION POLICIES

Amortization of intangibles and deferred charges is determined principally by the straight-line method. The cost in excess of net assets of businesses acquired prior to October 31, 1970, is not amortized since, in the opinion of management, there has been no diminution in value. Such amounts acquired after October 31, 1970, (\$4,399,154 including amounts attributable to unconsolidated subsidiaries and affiliates) and the cost of substantially all liquor licenses are amortized over a forty-year life. Franchise rights, deferred debt expense, and organization costs are amortized over fifteen-year lives.

#### INITIAL FRANCHISE FEE INCOME

Upon the sale of a franchise, the Company records the amount received or receivable as an asset and the fee as deferred franchise fee income. The initial franchise fee is recorded as income when the retail unit has been opened by the franchisee.

#### INVESTMENT TAX CREDITS

Investment tax credits are accounted for using the flow-through method.

#### RESEARCH AND DEVELOPMENT

The Company charges all research and development expenses (which are not material) to expense at the date incurred.

#### ESTIMATED FUTURE LEASE COSTS

Certain leased properties have been closed and the Company is providing for the estimated present value of these future net lease costs.

#### NET INCOME PER SHARE

Employee stock options and warrants attributable to the 8-3/4% Senior Notes are considered to be Common Stock equivalents in the computation of primary net income per share using the treasury stock method applied at the average market price during the period. Primary earnings per share for 1977 would have been \$2.56 had the 6-1/4% convertible subordinated debentures due 1995 been converted on April 1, 1976.

In the computation of fully-diluted net income per share, the Common Stock equivalents plus the shares issuable in the assumed conversion of convertible debentures for the period outstanding (all converted in fiscal year ended March 31, 1977) and notes are considered and interest expense (net of applicable income taxes) attributable to the convertible debentures and notes are added to net income. The treasury stock method is applied to Common Stock equivalents at the year end market price if higher than the average market price.

### NOTE B — ACQUISITIONS

During 1977, the Company acquired 25 Pizza Hut restaurants and the remaining interest in a 30% owned affiliate operating six Pizza Hut restaurants in transactions accounted for as purchases. The cost of these units was \$827,272 and exceeded the value of net assets acquired by \$554,927. The operations of these units have been included in the accompanying financial statements from the respective dates of their acquisition. The pro forma effect of these acquisitions assuming the units had been purchased at the beginning of 1976 would be immaterial to the consolidated results of operations.

During 1976, the Company acquired four Pizza Hut restaurants and the remaining interest in a 49% owned affiliate operating 33 Pizza Hut restaurants in exchange for 259,500 shares of Common Stock in transactions accounted for as poolings of interests. The 1976 consolidated statement of income includes net sales of \$5,927,480 and net income of \$522,513 (after elimination of intercompany transactions) for the period April 1, 1975,



to the respective dates of acquisition of the pooled companies.

## NOTE C — LONG-TERM DEBT

Other long-term debt consists of the following:

	1977	1976
10-3/8% Promissory Notes payable in semi-annual installments of \$725,000 from October, 1979 to April, 1990 .....	\$16,000,000	\$16,000,000
8-3/4% Senior Notes payable in annual installments of \$250,000 from March, 1978 to March, 1987 .....	2,415,892	2,400,616
Mortgage and Equipment Notes payable in monthly installments of \$20,659 including interest at rates from 3% to 10% maturing at various dates to 1989 .....	973,245	1,332,951
Notes payable to banks .....		4,107,150
7% Convertible Note due in 1978 .....	298,000	323,000
Other Unsecured Notes payable .....		567,125
	19,687,137	24,730,842
Less amounts due within one year .....	418,997	1,301,285
	<u>\$19,268,140</u>	<u>\$23,429,557</u>

The Senior Notes were issued with detachable Warrants to purchase at any time prior to March 2, 1987, 131,250 shares of Common Stock at \$6.17 a share. The \$2,500,000 face amount of these notes has been reduced by the discount attributable to the Warrants resulting in an effective interest rate of 9-1/3%.

Property, plant, and equipment with a carrying value of approximately \$2,330,000 has been pledged as collateral to the Mortgage and Equipment Notes.

The Convertible Note is convertible into shares of the Company's Common Stock at \$21.09 a share.

The Company has agreed, under certain long-term agreements, to maintain working capital of \$7,000,000

and to maintain a current ratio of at least 1.25 to 1. The agreements also contain certain restrictions which, among other things, prohibit the payment of dividends or the purchase of the Company's Common Stock unless certain debt service and earnings tests are met. Under the most restrictive of these requirements approximately \$9,200,000 will be available during the year ending March 31, 1978 for such purposes.

Maturities of long-term debt for the next five years are as follows: 1978 — \$418,997; 1979 — \$694,595; 1980 — \$1,105,627; 1981 — \$1,799,170; 1982 — \$1,798,826.

## NOTE D — SALE AND LEASEBACK TRANSACTIONS

During the two years ended March 31, 1977, the Company constructed and sold the following properties to outside parties and leased the properties back for periods of 20 to 22 years. The net of the gains and losses on such transactions was immaterial.

	Properties Sold	Selling Price
1977 .....	.28	\$ 5,379,547
1976 .....	.89	\$16,800,260

## NOTE E — STOCK OPTIONS

Under the terms of the employee stock option plans, the Company may grant options to officers and employees to purchase shares of its Common Stock at a price not less than the fair market value of the stock at date of grant. Activity under these plans is summarized as follows:

	Number of Shares	Option Price Per Share	Total
Outstanding			
March 31, 1975 ....	255,569	\$ 6.41 to \$18.99	\$2,835,288
Granted .....	104,575	14.67 to 21.75	1,698,369
Canceled .....	(39,817)	10.09 to 15.00	(456,592)
Exercised .....	(76,929)	6.41 to 18.99	(839,135)
Outstanding			
March 31, 1976 ....	243,398	8.67 to 21.75	3,237,930
Granted .....	144,037	19.63 to 26.25	3,387,623
Canceled .....	(24,922)	9.70 to 26.25	(356,776)
Exercised .....	(62,656)	9.70 to 18.99	(766,805)
Outstanding			
March 31, 1977			
(of which			
62,584 were			
exercisable) ....	299,857	\$ 8.67 to \$26.25	\$5,501,972



## Notes to Consolidated Financial Statements (continued)

Became exercisable in 1976 .....	72,428	\$ 6.41 to \$18.99	\$ 801,202
Became exercisable in 1977 .....	56,202	\$ 8.67 to \$21.75	\$ 750,418

At March 31, 1977, Common Stock was reserved as follows:

	Shares
Employee stock option plan .....	322,257
Warrants to purchase Common Stock at \$6.17 a share .....	131,250
Convertible note .....	14,130
	<u>467,637</u>

### NOTE F — LEASES

Total rent expense for all leases is summarized as follows:

	1977	1976
Financing leases:		
Minimum rentals .....	\$15,585,816	\$12,358,425
Contingent rentals .....	524,540	452,995
Other leases:		
Minimum rentals .....	4,969,585	4,114,919
Contingent rentals .....	1,672,907	1,157,953
Sublease rental income .....	(666,148)	(597,384)
	<u>\$22,086,700</u>	<u>\$17,486,908</u>

Contingent rentals represent mileage rates on transportation equipment and additional rentals on restaurant buildings based upon a percentage of sales.

The future minimum rental commitments as of March 31, 1977, for all noncancelable leases are as follows:

	Total	Other Leases		
		Restaurant Financing Leases	Restaurants	Buildings and Equipment
1978 .....	\$ 20,667,065	\$ 17,443,367	\$ 2,100,234	\$ 1,123,464
1979 .....	19,630,368	17,409,058	1,621,608	599,702
1980 .....	19,061,551	17,397,584	1,315,082	348,885
1981 .....	18,723,622	17,363,061	1,180,461	180,100
1982 .....	18,382,750	17,238,553	1,080,071	64,126
1983-87 .....	85,182,371	80,946,267	4,206,104	30,000
1988-92 .....	67,819,968	65,181,413	2,622,055	16,500
1993-97 .....	37,856,541	36,949,390	907,151	
Thereafter .....	294,055	46,826	247,229	
	<u>\$287,618,291</u>	<u>\$269,975,519</u>	<u>\$15,279,995</u>	<u>\$2,362,777</u>

The above commitments have not been reduced by anticipated rental income from existing noncancelable subleases in the approximate amount of \$3,276,000. These subleases relate primarily to restaurants and generally cover a shorter term than the respective prime lease. The

restaurant leases generally include renewal provisions of from 5 to 20 years at the original rental rates.

The estimated present values of minimum lease commitments under financing leases (as defined by the Securities and Exchange Commission) are summarized as follows:

	1977	1976
Restaurants .....	\$125,331,530	\$101,862,689
Less: Sublease rentals .....	(188,353)	(914,551)
Equipment .....		591,846
	<u>\$125,143,177</u>	<u>\$101,539,984</u>

Interest rates implicit in the financing leases range from 5.3% to 17.1% for restaurants (weighted average 10.2%).

If all financing leases had been capitalized, it is estimated that net income for the years 1977 and 1976 would have been reduced by \$1,721,000 and \$1,323,000, respectively. This computation assumes that the estimated present values (including present values attributable to land) were amortized on a straight-line basis over the terms of the leases and that interest expense was accrued on the outstanding lease obligations at the rates shown above. The amounts included for amortization of leased property (including land) and interest expense were \$6,723,000 and \$11,623,000, respectively in 1977 and \$5,567,000 and \$9,117,000, respectively in 1976.

### NOTE G — INCOME TAXES

Federal and state income taxes consist of the following:

	1977		1976	
	Current	Deferred	Current	Deferred
Federal ..	\$14,731,676	\$ 893,797	\$10,638,495	\$352,970
State ....	2,246,671	118,856	1,579,842	30,693
	<u>\$16,978,347</u>	<u>\$1,012,653</u>	<u>\$12,218,337</u>	<u>\$383,663</u>

The components of deferred income tax expense result from the use of the following:

	1977	1976
Provision for future lease costs .....	\$ (200,600)	\$(400,000)
Accelerated depreciation for tax purposes .....	1,119,509	788,121
Other .....	93,744	(4,458)
	<u>\$ 1,012,653</u>	<u>\$ 383,663</u>

The reasons for the difference between the total tax expense and the amount computed by applying the statutory Federal income tax rate of 48% to income before income taxes are as follows:

	1977	1976
48% of pre-tax income . . . . .	\$19,007,479	\$13,374,418
Add state taxes net of Federal tax benefit . . . . .	1,230,074	837,478
	20,237,553	14,211,896
Deduct:		
Tax benefit of write-off of investment in Germany . . . . .		(740,000)
Investment tax credit . . . . .	(2,025,714)	(1,455,831)
Other . . . . .	(220,839)	585,935
	<u>\$17,991,000</u>	<u>\$12,602,000</u>

#### NOTE H — CONTINGENT LIABILITIES

The Company has guaranteed obligations of unconsolidated affiliated companies and others amounting to approximately \$3,845,000.

At March 31, 1977, as a result of various transactions, the Company was guarantor of lease commitments of certain franchisees. The annual rentals and the estimated present value of these guaranteed leases is summarized as follows:

Transaction	Annual Rental	Present Value
Guaranteed for a fee . . . . .	\$204,545	\$1,201,712
Guaranteed for minority interest . . . . .	421,977	3,214,579
Formerly owned units sold to franchisees . . . . .	362,179	2,054,910
	<u>\$988,701</u>	<u>\$6,471,201</u>

The Company is a party to lawsuits arising out of the normal course of its business. The disposition of such litigations will not, in the opinion of management and legal counsel, result in a material adverse effect on the Company's financial position.

The Company on March 1, 1977, signed a long-term lease agreement with the City of Wichita, Kansas relating to the issuance of \$8,000,000 in industrial revenue bonds to be used to construct a new Pizza Hut, Inc. headquarters facility. The sale of the bonds will be consummated during the next fiscal year. The transaction will be accounted for as a capitalized lease obligation.

#### NOTE I — QUARTERLY RESULTS OF OPERATIONS (Unaudited)

The following is a summary of the unaudited quarterly results of operations for the year ended March 31, 1977:

	Three Months Ended:			
	June 30	September 30	December 31	March 31
	(Thousands of dollars except per share data)			
Total net sales	\$71,941	\$79,783	\$79,531	\$77,838
Gross profit	43,275	46,723	46,419	45,229
Net income	5,133	5,632	5,749	5,094
Net income per share:				
Primary	.69	.70	.68	.60
Fully diluted	.62	.66	.67	.60

For the quarter ended March 31, 1977, the Company adjusted the provision for income taxes to reduce the annual effective income tax rate due primarily to higher than anticipated investment tax credits. The adjustment increased net income for the quarter then ended by approximately \$640,000 (\$.08 per share).

#### Report of Ernst & Ernst Independent Auditors

Stockholders and Board of Directors  
Pizza Hut, Inc.  
Wichita, Kansas

We have examined the consolidated balance sheets of Pizza Hut, Inc. and subsidiaries as of March 31, 1977 and March 31, 1976, and the related statements of consolidated income, stockholders' equity, and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the consolidated financial position of Pizza Hut, Inc. and subsidiaries at March 31, 1977 and March 31, 1976, and the consolidated results of their operations and changes in their financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Wichita, Kansas  
May 17, 1977

*Ernst & Ernst*  
**E•E**



### **Corporate Data**

### **10-K Report**

Common Stock  
Stock symbol: PIZ - Traded  
NYSE  
Transfer Agents:  
Citibank, N.A.  
New York and  
First National Bank in Wichita.  
Registrars:  
Citibank, N.A.  
New York and  
The Fourth National Bank &  
Trust Co., Wichita.

A copy of Pizza Hut, Inc.'s  
10-K report filed with the  
Securities and Exchange  
Commission for 1977 can be  
obtained without charge by  
writing to:  
  
James J. Byrne  
Director of Investor Relations  
Pizza Hut, Inc.  
P.O. Box 428  
Wichita, Kansas 67201

### **Corporate Offices**

### **Auditors**

10225 E. Kellogg  
Wichita, Kansas 67207  
Tel. (316) 687-4111

Ernst & Ernst  
Wichita, Kansas



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be a member of this organization, and fully  
subscribe to its code of ethics.





